

Message Text

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ACTION MMO-02

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FM AMEMBASSY LAGOS

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INFO USDOC WASHDC

AMCONSUL IBADAN

AMCONSUL KADUNA

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TAGS: ECRP, EGEN, EFIN, ETRD, NI

SUBJECT: CERP 200: COMMENTS ON NIGERIAN BUDGET FOR FY 1978-79

REF: (A) LAGOS 4293, (B) LAGOS 4291, (C) LAGOS 4150

SUMMARY: PRESSURED BY DECLINING OIL REVENUES AND ACCELERATING EROSION OF FOREIGN EXCHANGE RESERVES, THE NIGERIAN GOVERNMENT IN ITS FY 1978-79 BUDGET (APRIL 1, 1978 TO MARCH 31, 1979) INTRODUCED A SERIES OF AUSTERITY MEASURES DESIGNED TO DEFLATE THE ECONOMY AND REORDER ECONOMIC PRIORITIES AWAY FROM RELIANCE ON PETROLEUM REVENUES. IMPORTS ARE CUT AND FRESH ACCENT IS PLACED ON PRODUCTION IN AGRICULTURE AND MANUFACTURING. ALTHOUGH MANY OBSERVERS FEEL THAT GOVERNMENT MEASURES WERE IN FACT RATHER MILD, EMBASSY BELIEVES THEY ARE SUFFICIENTLY FORCEFUL FIRST STEP IN REPLACING RHETORIC WITH DEEDS. ECONOMIC RETRENCHMENT WILL RESULT IN SHARP DROP GDP GROWTH RATE, PERHAPS DOWN TO MINIMAL OR ZERO GROWTH THIS YEAR IN CONSTANT VALUE TERMS. MAJOR MEASURES INTRODUCED BY DUGET SPEECHES INCLUDE: CUTS IN APPROVED CAPITAL AND RECURRENT BUDGETS, SMALLER FEDERAL SUBSIDIES

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TO STATE AND LOCAL GOVERNMENTS, FEDERAL GOVERNMENT'S TRNING OVER PRIMARY RESPONSIBILITY FOR HEALTH, HOUSING AND EDUCATION TO STATE AND LOCAL AUTHORITIES, HIGHER TARIFFS, EXPANDED BANNING OR LICESNSING OF IMPORTED GOODS, MORE RESTRICTIVE CREDIT POLICIES AND PROMISE OF NO ACROSS-THE-BOARD WAGE INCREASES. THE BUDGET ACKNOWLEDGES IMPLICITLY THAT NIGERIA IS BECOMING MORE DEPENDENT ON FOREIGN LOANS AND INVESTMENT TO SPARK COUNTRY'S DEVELOPMENT, BUT

OFFERS FEW NEW INVESTMENT INCENTIVES EXCEPT IN AGRICULTURE. BUDGET SPEECHES MADE ONLY PASSING REFERENCE TO PETROLEUM WHICH MAY INDICATE GOVERNMENT'S OIL POLICY IS UNDER EXAMINATION. SOUTH AFRICA WAS NOT MENTIONED, PRESUMABLY TO AVOID FURTHER DARKENING INVESTMENT SCENE. ECONOMIC HARD TIMES WILL EXACT GREATEST TOLL ON AVERAGE NIGERIAN CITIZEN. ALTHOUGH THIS WILL PROBABLY BE A GENTLY VOICED ISSUE INCOMING POLITICAL CAMPAIGNS, WE DO NOT BELIEVE ECONOMIC SLOWDOWN WILL DISRUPT PROGRESS TOWARD CIVILIAN RULE IN 1979. WE ALSO FORESEE FALLING IMPORT DEMAND FOR U.S. PRODUCTS DUE TO ECONOMIC DOWNTURN AND TRADE RESTRICTIONS. AMERICAN CONSUMER GOODS, VEHICLES AND CONSTRUCTION RELATED EXPORTS SHOULD BE HARDEST HIT. GROWTH OF AGRICULTURAL COMMODITY SALES TO NIGERIA WILL ALSO SLOW DOWN BUT STRENGTHENED COMMERCIAL LINKS BUILT UP OVER PAST THREE YEARS SHOULD HELP TOTAL U.S. EXPORTS TO NIGERIA TO AGAIN TOP \$9000 MILLION.

THE ECONOMY - YEAR OF RETRENCHMENT BEGINS: BUDGET SPEECHES SUPPORT

MAIN POINTS OF RECENT EMBASSY FORECAST ON NIGERIAN ECONOMY(LAGOS 3238). THE REDUCED BUDGET IMPOSES A SIGNIFICANT SHRINKAGE IN MONEY SUPPLY GROWTH RATE, MORE DOMESTIC TAXES, HIGH IMPORT DUTIES, FEWER NEW CONSTRUCTION PROJECTS AND NO GENERAL WAGE INCREASES, ALL OF WHICH SPELL LITTLE OR NO REAL GDP GROWTH IN THE COMING FISCAL YEAR. ALTHOUGH A NUMBER OF STRINGENT MEASURES WERE MODIFIED AT THE LAST MINUTE CAUSING CUTBACKS TO BE LESS SEVERE THEN EXPECTED, MOST OBSERVERS BELIEVE THAT FY 1978-79 LIMITED OFFICIAL USE

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BUDGET IS AN EFFECTIVE FIRST STEP IN NIGERIA'S REORDERING OF NATIONAL PRIORITIES WITHIN THE LIMITED MEANS AT ITS DISPOSAL. ULTIMATE ACHIEVEMENT OF BUDGET'S OBJECTIVES REMAINS AN OPEN QUESTION. NIGERIA HAS IMPLICITLY BECOME MORE DEPENDENT ON FOREIGN INVESTMENT TO SPARK GROWTH IN MANUFACTURING BUT HAS OFFERED FEW NEW INVESTMENT INCENTIVES ALTHOUGH OUTLOOK FOR AGRICULTURE IS MUCH BRIGHTER. GOVERNMENT ALSO DEPENDENT ON

FOREIGN BANKS AND INSTITUTIONS TO LEND \$2.5 BILLION DURING FISCAL YEAR TO FINANCE ESSENTIAL PROJECTS OF TRUNCATED DEVELOPMENT PLAN. ADDITIONAL \$4.2 BILLION WOULD BE RAISED DOMESTICALLY THROUGH LOANS AND NEW TAXES. FEDERAL GOVERNMENT ALSO COUNTING ON STATE AND LOCAL AUTHORITIES TO FUND GREATER SHARE OF ESSENTIAL SERVICES INCLUDING EDUCATION, HEALTH AND HOUSING EVEN THOUGH STATE AND LOCAL GOVERNMENTS HAVE NOT YET DEVELOPED EFFICIENT TAX MECHANISM TO SUPPORT THEMSELVES LET ALONE TAKE ON NEW RESPONSIBILITIES. SIGNIFICANT POLITICAL PRESSURES WILL ARISE FROM REALLOCATION OF SHRINKING ECONOMIC PIE BUT NIGERIANS SEEM TO BE VIEWING THE RETRENCHMENT EXERCISE WITH

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REASONABLE GOOD WILL. CONSEQUENTLY, EMBASSY CONTINUES TO BELIEVE THAT ECONOMIC SLOWDOWN WILL NOT DISRUPT PROGRESS TOWARD CIVILIAN RULE IN LATE 1979 ALTHOUGH ECONOMIC FRUSTRATIONS WILL PROVIDE AMMUNITION FOR PARTICIPANTS IN THE UPCOMING POLITICAL CAMPAIGNS. MEASUREMENT OF THE POPULAR PULSE THUS FAR, HOWEVER, INDICATES THAT CRITICISM OF MILITARY REGIME WILL BE VOLUNTARILY RESTRAINED TO AVOID PROVOKING REACTION.

SPOTLIGHT ON AGRICULTURE: AFTER YEARS OF MERE LIP SERVICE TO THE (IMPORTANCE OF AGRICULTURE) THE GOVERNMENT IS FINALLY OFFERING SIGNIFICANT INCENTIVES FOR AGRICULTURAL INVESTMENT. THE REMOVAL OF PRICE CONTROLS ON ALL LOCALLY PRODUCED AGRICULTURAL PRODUCTS SHOULD SOON RESULT IN INCREASED PRODUCER PRICES. HIGHER FARM INCOMES, IN CONJUNCTION WITH DRYING UP OF EMPLOYMENT OPPORTUNITIES IN URBAN AREAS, ESPECIALLY IN CONSTRUCTION, WILL TEND TO SLOW DOWN RURAL MIGRATION TO CITIES AND INCREASE PRODUCTION. HIGHER TARIFFS AND INCREASED IMPORT RESTRICTIONS SHOULD CAUSE REALLOCATION OF DOMESTIC CAPITAL AWAY FROM TRADITIONAL ACTIVITIES TO AGRIBUSINESS INVESTMENT. FAVORABLE CREDIT AND TAX MEASURES SHOULD ALSO PROMOTE GREATER INVESTMENT FLOWS INTO AGRIBUSINESS. ALTHOUGH ALL THIS IS

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GOOD NEWS, MOST IMPORTANT INCENTIVE FOR POTENTIAL FOREIGN INVESTORS

IS MOVING ALL AGRIBUSINESS ACTIVITY FROM SCHEDULE II OF ENTERPRIDS PROMOSITON DECREE (40 PERCENT FOREIGN OWNERSHIP) TO SCHEDULE III (60 PERCENT FOREIGN OWNERSHIP). ONLY TWO MAJOR PROBLEM AREAS AFFECTING AGRICULTURAL INVESTMENT REMAIN. THE FIRST IS THE FEDERAL MINISTRY OF AGRICULTURE WHICH ACTS AS THE COORDINATOR FOR ALL PUBLIC AND MUCH PRIVATE AGRIBUSINESS ACTIVITY THROUGHOUT THE COUNTRY. THE MINISTRY IS STILL UNDERSTAFFED AND TALENT POOR, AND MINISTRY OFFICIALS DO NOT KNOW IF THE GOVERNMENT WILL ALLOCATE NECESSARY RESOURCES TO MAKE THE MINISTRY EFFECTIVE. THE SECOND IS THE NEW LAND USE DECREE WHICH PUTS MOST UN-DEVELOPED LAND IN THE HANDS OF STATE OFFICIALS, LEAVING TRADITIONAL RULERS AS THE PRINCIPAL LOSER. ALTHOUGH THE GOVERNMENT HAS DECREED THAT IT NOW HAS THE EXCLUSIVE RIGHT TO CONTROL LAND USE, IT HAS RUN PREDICTABLY INTO VERY STRONG OPPOSITION. SINCE TRADITIONAL RULERS CAN EFFECTIVELY PREVENT SMOOTH RUNNING OF ANY LOCAL OPERATIONS, BUSINESSMEN WILL PRESUMABLY DELAY RENTING LAND UNTIL GOVERNMENT AND TRADITIONAL RULERS CAN RESOLVE DIFFERENCES.

IMPORTS WILL DECLINE: AFTER THREE YEARS OF SPECTACULAR 30 TO 50 PERCENT IMPORT GROWTH RATES, THE NEWLY ANNOUNCED TRADE AND FISCAL MEASURE VIRTUALLY GUARANTEE A DECREASE REPEAT DECREASE IN TOTAL IMPORTS FOR CY 1978 IN CONSTANT VALUE TERMQ DESPITE IMPORT GROWTH FOR THE FIRST QUARTER OF THE YEAR. THE MOST IMPORTANT ACTIONS AFFECTING IMPORTS ARE : 1) CUTBACKS IN GOVERNMENT BUDGETS, 2) GENERALLY HIGHER TARIFFS, 3) IMPORT PROHIBITIONS AND LICENCES AND 4) 100 PERCENT DEPOSIT ON ALL LETTERS OF CREDIT FOR NON-CAPITAL IMPORT. ONE REASON FOR THESE RESTRICTIONS IS FMG'S DESIRE TO ENCOURAGE ESTABLISHMENT OF IMPORT SUBSTITUTION INDUSTRIES. HOWEVER, MAIN REASON FOR TRADE AND FISCAL RESTRICTIONS IS FMG'S INCREASING PREOCCUPATION WITH SHORING UP NIGERIA'S DETERIORATING FOREIGN EXCHANGE POSITION. IN FACT, NIGERIA CONTINUES TO ENJOY LIMITED OFFICIAL USE

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A TRADE SURPLUS, \$2.1 BILLION IN CY 1977, ALTHOUGH THE SURPLUS SHRANK FROM THE \$2.4 RECORDED IN CY 1976. MOST OF LAST YEAR'S ESTIMATED \$960 MILLION BALANCE OF PAYMENTS DEFICIT WAS CAUSED BY A CHRONIC SERVICES ACCOUNT DEFICIT. ALTHOUGH THE NEW RESTRICTIONS WILL HELP TO REDUCE CONSUMPTION OF LUXURY GOODS, NECESSITIES ARE ALSO AFFECTED. SOME BELIEVE THAT THE BAN ON FROZEN MEAT AND POULTRY WILL CAUSE A SERIOUS PROTEIN SHORTAGE HERE. GOVERNMENT LICENSING OF TRUCKS AND BUSES PROBABLY WILL RESULT IN SPOT SHORTAGES OF THESE CRITICAL ITEMS. TARIFF INCREASES AFFECTING RICE AND CORN WILL NOT DAMPEN DEMAND SINCE THERE ARE NO SUBSTITUTES AVAILABLE, BUT THE MAN IN THE STREET, ALREADY HIT HARD BY INFLATION, WILL FIND IT INCREASINGLY DIFFICULT TO FEED HIMSELF. NONETHELESS, THE RESTRICTIONS COULD HAVE BEEN WORSE. AS REPORTED IN LAGOS 3657, THE GOVERNMENT WAS GOING TO LICENSE RICE AND CORN WHICH WOULD HAVE RESULTED IN WIDESPREAD SHORTAGES AND PERHAPS SOME STARVATION. ONLY INTENSIVE

LAST MINUTE LOBBYING BY PRIVATE BUSINESSES MADE THE GOVERNMENT
SEE REASON.

BANKS GIVE BUDGET A MEDIUM HELLO: BUFFETED BY CURRENCY SCANDALS,
EVER-TIGHTENING REGULATIONS, OVERNIGHT POLICY CHANGES BY GOVERN-
MENT AND THE USUAL BUREAUCRATIC OBSTRUCTIONISM, THE BANKS WERE
PREPARED FOR THE WORST ON APRIL 1 (SEE LAGOS 1754). THEY LOBBIED
HARD TO SOFTEN THE IMPACT OF THE RUMORED UPCOMING RESTRICTIONS
AND WERE PARTIALLY SUCCESSFUL. BIGGEST VICTORY WAS WON BY SMALL
AND/OR NEW BANKS WHO WILL NOT BE AFFECTED BY REDUCTION OF CREDIT
EXPANSION CEILING TO 30 PERCENT. ALL U.S. BANKS ARE IN THIS
CATEGORY. SUCCESSFUL LOBBYING EFFORT WAS LED BY INTERNATIONAL
MERCHANT BANK (FIRST CHICAGO). PRESSURE TO REDUCE EXPATRIATE
QUOTAS HAS ALSO EASED AT LEAST TEMPORARILY. ON THE OTHER HAND,

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THE NEW EXCESS PROFITS TAX ON EMPLOYED CAPITAL WAS AN UN-
PLEASANT SURPRISE. BANKS HAD LOBBIED FOR A RISE IN INTEREST
RATES, BUT THIS BACKFIRED BECAUSE ALTHOUGH LENDING RATES IN-
CREASED BY ABOUT ONE PERCENT, THE COST OF FUNDS INCREASED BY
TWO PERCENT REDUCING PROFITS ON FUNDS ON LOAN IN SOME SECTORS
TO LESS THAN ONE PERCENT. CONSENSUS IS THAT NET EFFECT OF
NEW BANKING MEASURES WILL BE MILDLY RESTRICTIVE. THIS COUPLED
WITH THE BUDGET'S OTHER GENERALLY DEFLATIONARY PROVISIONS
(E.G. 100 PERCENT LETTER OF CREDIT DEPOSITS, HIGHER TARIFFS
AND IMPORT RESTRICTIONS, HIGHER TAXES AND CUTBACKS IN GOVERN-
MENT EXPENDITURES) WILL RESULT IN LEANER BANK PROFITS THIS

FISCAL YEAR. NONETHELESS, AS ONE U.S. BANKER SAID, QUOTE 'IT
COULD HAVE BEEN WORSE, MUCH WORSE.' UNQUOTE.

FOREIGN INVESTMENT - NO NEWS IS BAD NEWS: WITH THE FEDERAL
GOVERNMENT PARTLY CLSING THE DOOR TO IMPORTS, MANY NAIRA
RICH LOCAL TRADINT COMPANIES WILL BE REINVESTING THEIR SUB-
STANTIAL NONCONVERTIBLE PROFITS INTO IMPORT SUBSTITUTION
INDUSTRIES, PRIMARILY AGRIBUSINESS BUT ALSO MANUFACTURING.
THIS WAS FMG'S INTENTION. HOWEVER, NIGERIA REMAINS DEPENDENT
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ON NEW FOREIGN INVESTMENT TO FINANCE NEEDED IMPORTED CAPITAL
GOODS AND EXPERTISE. UNFORTUNATELY, THE BUDGET OFFERED NO NEW
INCENTIVES TO FOREIGN INVESTMENT EXCEPT IN AGRICULTURE AND A
SMALL GENERAL INCREASE IN NET DIVIDENT RATE FROM 16 1/2 TO
20 PERCENT. THE GOVERNMENT DID NOT ADDRESS THE MAIN PROBLEMS
BLOCKING NEW FOREIGN INVESTMENT IN NIGERIA, I.E., STABILITY OF
RULES AND REGULATIONS AFFECTING BUSINESS, MANAGERIAL CONTROL

AND UNHAMPERED FLOW OF REMITTANCES GENERATED BY ADEQUATE
TECHNICAL AND MANAGERIAL FEES. OUTLOOK IS THAT MAJORITY OF
POTENTIAL NEW INVESTORS WILL CONTINUE TO MARK TIME UNTIL
CONDITIONS IMPROVE.

CONSPICUOUS BY THEIR ABSENCE - PETROLEUM & SOUTH AFRICA: IT IS
NOTEWORTHY THAT NEITHER OF THE TWO BUDGET SPEECHES DISCUSSED
NIGERIAN OIL PLICY OR PRODUCTION IN ANY DETAIL BEYOND
OBASANJO'S ADMISSION THAT QUOTE THE PROJECTED REVENUES FOR THE
NEXT FINANCIAL YEAR WILL CERTAINLY BE LESS THAN WE REALIZED LAST
YEAR. UNQUOTE. FMG IS PRESUMABLY RE-EXAMING ITS OIL PRICING
AND PRODUCTION POLICY AND DOES NOT WANT TO PREJUDICE
CURRENT TALKS WITH THE OIL COMPANIES. ABSENCE OF ANY REFERENCE
TO SOUTH AFRICA IS SURPRISING IN AFTERMATH OF UPROAR OVER BARCLAY'S
BANK (LAGOS 3669). WE BELIEVE THAT FMG IS DELIBERATELY DOWN-
PLAYING ITS HOSTILE POLICY TOWARDS SOUTH AFRICA TO CALM FOREIGN
COMPANIES AND QUIETLY PULL BACK FROM THE THREATENING POSTURE IT
ASSUMED WITH ITS BOMBAST AT THE LAGOS ANTI-APARTHEID CONFERENCE
IN AUGUST 1977. IN SUM, THE REGIME SEEMS TO HAVE BECOME AWARE
THAT ITS EARLIER QUOTE IT'S EITHER THEM OR US UNQUOTE STANCE
IS SIMPLISTIC AND COUNTER-PRODUCTIVE.

COMMON MAN IS CASUALTY IN WAR ON INFLATION: ALTHOUGH NO
MEASURE IN BUDGET WAS CITED SPECIFICALLY AS ANTI-INFLATION DEVICE,
SEVERAL ELEMENTS OF BUDGET PROVIDE ANTI-INFLATION IMPACT. EXAMPLES
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INCLUDE LACK OF ACROSS-THE-BOARD WAGE INCREASES, MEASURES TO
REDUCE THE MONEY SUPPLY AND REDUCED GOVERNMENT SPENDING AND SUBSIDIES

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THEIR EFFECT SHOULD BE FELT IN ABOUT NINE TO TWELVE MONTHS.
IN THE NEXT FEW MONTHS, HOWEVER, THE CURRENT 30 TO 40 PERCENT
INFLATION RATE (EMBASSY ESTIMATE. FMG ESTIMATE IS 25 PERCENT.
OTHER ESTIMATES ARE AS HIGH AS 40 TO 50 PERCENT.) WILL JUMP
BECAUSE OF INCREASED TARIFFS ON ESSENTIAL COMMODITIES, E.G, RICE,
AND THE REMOVAL OF PRICE CONTROLS. IF THE GOVERNMENT KEEPS ITS
PROMISE NOT TO GRANT MAJOR WAGE INCREASES, THE AVERAGE NIGERIAN
WILL HAVE TO FACE MORE PRIVATIONS, AND THESE ARE BECOMING
INCREASINGLY PAINFUL. PROBLEM IS COMPOUNDED BY INEVITABLE
INCREASE IN UNEMPLOYMENT.

IMPLICATIONS FOR U.S. BUSINESS: THE MOST OBVIOUS EFFECT OF THE
NEW MEASURES WILL BE TO DEPRESS U.S. EXPORTS TO NIGERIA.
CONSUMER GOODS ARE EITHER BANNED OR HAVE PROHIBITIVE
TARIFFS ATTACHED. HIGH VEHICLE TARIFFS WHICH INCREASE WITH
ENGINE VOLUME EFFECTIVELY BAR THE IMPORTATION OF U.S. MADE
AUTOMOBILES. LICENSING OF TRUCKS AND BUSES MAKE SALES IN THIS
AREA CHANCEY. FROZEN MEAT AND POLYMER IS NOW BANNED. THE HIGH
DUTY ON RICE WILL STYMIE FUTURE SALES GROWTH. IN ADDITION,
THE GOVERNMENT'S AUSTERITY BUDGET TOGETHER WITH THE NEW FISCAL
MEASURES TO DRYUP LIQUIDITY WILL RESULT IN FEWER SALES
OPPORTUNITIES ESPECIALLY IN THE CONSTRUCTION INDUSTRY. U.S. BUSINESS
IN CY 1978 WILL BE LUCKY TO MATCH LAST YEAR'S EXPORT RECORD
(\$957 MILLION) IN CONSTANT DOLLAR TERMS. IF THE GOVERNMENT'S FOR-
EIGN EXCHANGE BUDGET FOR FY 1978/79 HOLDS TURE (\$10.4 BILLION
WHICH IS 83 PERCENT OF LAST YEAR'S FOREIGN EXCHANGE EXPENDITURES)
AND IF THE U.S. MAINTAINS ITS 11 TO 12 PERCENT SHARE OF NIGERIA'S
IMPORT TRADE, U.S. EXPORTS TO NIGERIA COULD DROP TO ABOUT
\$80; MILLION. HOWEVER, SINCE DEMAND FOR U.S. AGRICULTURAL
COMMODITIES SHOULD CONTINUE TO HOLD STEADY, WE DOUBT THAT U.S.
TRADE WILL DROP THIS FAR. LIKELY THAT U.S. EXPORTS WILL STAY
IN \$900-\$1,000 MILLION RANGE. ALTHOUGH THE PICTURE IS NOT AS
BLEAK FOR U.S. NON-PETROLEUM INVESTMENT, IT IS FAR FROM IDEAL.
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THE NIGERIAN GOVERNMENT HAS YET TO OFFER SUFFICIENT INCENTIVES
OR GUARANTEES TO MAKE NIGERIA'S INVESTMENT CLIMATE ATTRACTIVE
ENOUGH FOR LARGE SCALE U.S. INVESTMENT. AGRICULTURE IS THE
EXCEPTION. ASSUMING THAT U.S. BUSINESS ACCEPTS THE POLITICAL
RISKS ENTAILED IN NEXT YEAR'S CHANGEOVER TO CIVILIAN RULE,
THE FEDERAL GOVERNMENT'S LATEST INCENTIVES HAVE CREATED VERY
GOOD CONDITIONS FOR INVESTMENT IN AGRICULTURE AND RELATED
AGRO-INDUSTRIES. SALES POTENTIAL FOR AGRICULTURAL MACHINERY
SHOULD ALSO BRIGHTEN.

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